

No Estoppel Because Excess Insurer Has No Duty to Reserve Rights in the Absence of a Duty to Defend

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Applying Pennsylvania law, a federal district court has held that an excess insurer need not reserve rights in the absence of a duty to defend, and therefore the excess insurer was not estopped from denying coverage despite its failure to issue a coverage letter until five years after first receiving notice of the claims. *TIG Ins. Co. v. Tyco Int'l Ltd.*, 2013 WL 249973 (M.D. Pa. Jan. 23, 2013). The court also held that coverage for the claims was barred by the policy's "prior knowledge exclusion."

The policy at issue provided the third excess layer of general liability coverage. It had a policy period of July 1, 1997 to July 1, 1998, with limits of liability of \$30 million excess of \$90 million. The policy included an extended reporting period (ERP) that provided coverage for claims made during the policy period resulting from an occurrence that took place during the period of June 1, 1993 and July 1, 1997. The ERP was subject to a prior knowledge exclusion, which barred coverage for "any claims resulting from an occurrence of which the insured had actual or constructive notice prior to [July 1, 1997]."

On May 5, 1997, a fire destroyed a large document storage warehouse. The insured was responsible for the fire protection sprinkler system, which was not turned on at the time of the fire. The following year, a number of entities that stored documents at the warehouse brought suit against the owner and operator of the warehouse as well as against the insured. These suits were consolidated and defended by the insured's insurers. Notice of the actions was provided to the third excess insurer in October 2002 and January 2003. The suits were defended by the underlying insurers, which ultimately paid out \$67.4 million to defend and settle the claims. An additional claim on account of the same fire was brought by a hospital in 1999. The insured provided notice of this claim to the third excess insurer in September 2007 and sought its participation in efforts to resolve the claim. The third excess insurer responded with a general reservation of rights in January 2008, raising for the first time the possibility of denying coverage for any claim arising out of the fire. Two months later, the insurer sent a second letter, identifying the prior knowledge exclusion as a specific basis for denying coverage.

In the action for a declaratory judgment that followed, the court rejected the insured's argument that the insurer was estopped from denying coverage because of its five-year delay in reserving rights. According to the court, in order for estoppel to apply, the insured had to establish: (i) inducement by the insurer—either through its acts or representations or through silence when it had an obligation to speak—to believe certain facts; (ii) justifiable reliance by the insured on that inducement; and (iii) prejudice to the insured. As to the first element, the court held that because it is the duty to defend that gives rise to the duty to reserve rights, the insurer had no obligation to speak before the underlying insurance had been exhausted, and therefore the insured could not as a matter of law establish inducement. The court also concluded, in any event, that the insured failed to establish prejudice, providing no evidence that an earlier reservation of rights letter from the third excess insurer would have altered the settlement strategy carried forward by the underlying insurers.

Turning to the prior knowledge exclusion, the court held that, in the absence of extrinsic evidence, the exclusion clearly precluded coverage for claims arising from an occurrence about which the insured knew before the policy's inception on July 1, 1997, including the claims here arising from the fire at the warehouse on May 5, 1997. The court rebuffed the insured's attempt to introduce extrinsic evidence of its intent to plug a coverage gap, holding that extrinsic evidence is only admissible to demonstrate policy terms' "latent ambiguity," rather than to reveal the parties' subjective intent. The court also rejected the insured's argument that the prior knowledge exclusion rendered the ERP illusory, concluding that claims arising from an occurrence within the ERP's timeframe but unknown until the start of policy period would not be excluded by the exclusion.